

Chapter IV

Borrowed Land : How does the “rug” under the Hong Kong economy work?

Hong Kong, the capitalist enclave consisting of 236 large and small islands, the Kowloon peninsula and the New Territories at the southern tip of China, is scheduled to be returned to China on July 1, 1997. Agreement on the return of Hong Kong was announced by the Sino-British Joint Declaration on December 19, 1984. Talks between UK and China on the sovereignty problem of the region started in September 1982, 15 years prior to the scheduled end of “lease” terms over the New Territories, the largest part of the colony, in 1997.

Why 1982? This is also due to a condition related to land in Hong Kong. In Hong Kong, average terms of mortgage loans, which is a major investment item for financial institutions, was 15 years. Therefore, when 1982 rolled around, the year 1997 came into the prospects of people in Hong Kong. Would Britain renew the lease contract? Concern over this problem consequently severely hampered business in the territory. In order to alleviate these concerns, the British government started difficult negotiations with its Chinese counterparts. Eventually in 1984, negotiations were resolved by an agreement that the UK would hand Hong Kong over to China at the end of the term of the lease on the New Territories, though the Chinese government did not formally admit the legitimacy of Britain's rule over the territory.

This article will describe the roles of the “rug,” being put under Hong Kong and to be handed over to the new owner soon. First, mono-ownership of land, a unique characteristic of land management in Hong

Kong, will be described. The supply and demand structure of the property market, and the impact of property on the financial market will then be discussed, the presence of the government being strong in all these areas.

Monopoly on Land Ownership: Developing land from land

Hong Kong has been a colony of the United Kingdom since 1842. The land is theoretically

owned by the Queen. To be precise, the Queen owns regions of Hong Kong Island, Kowloon peninsula, as well as being the biggest “tenant” of the New Territories and other islands. The Hong Kong government has exercised ownership rights over land on behalf of the Queen and enjoyed various benefits from these monopolistic rights.

First, the Hong Kong government holds a unique source of fiscal revenue through land sales, though its share is not extremely high. Land-related sources, however, i.e., rates (taxes for public service charged on property value), and transaction taxes, made up a certain amount and stable share of revenue. Figure 1 illustrates ratios of proceeds from land sales, taxes and other land-related

items among the colony's fiscal revenue. The share of proceeds from land sales, which may be described as a benefit of monopolized ownership, moved on as follows. It accounted for over 30% of Hong Kong's revenue in 1980 and 1981, when it recorded the highest share. It also accounted for



Public housing: Nests of half Hong Kong population

10% to 20% of total revenue during the other periods. The other land-related revenue items, including real estate transactions tax and rates, accounted for a further 10% to 20% of the colony's fiscal revenue. In all, 20% to 30% of the colony's fiscal revenue is derived from land and property-related items. These items secured a considerable margin of comfort in the Hong Kong government's fiscal management.

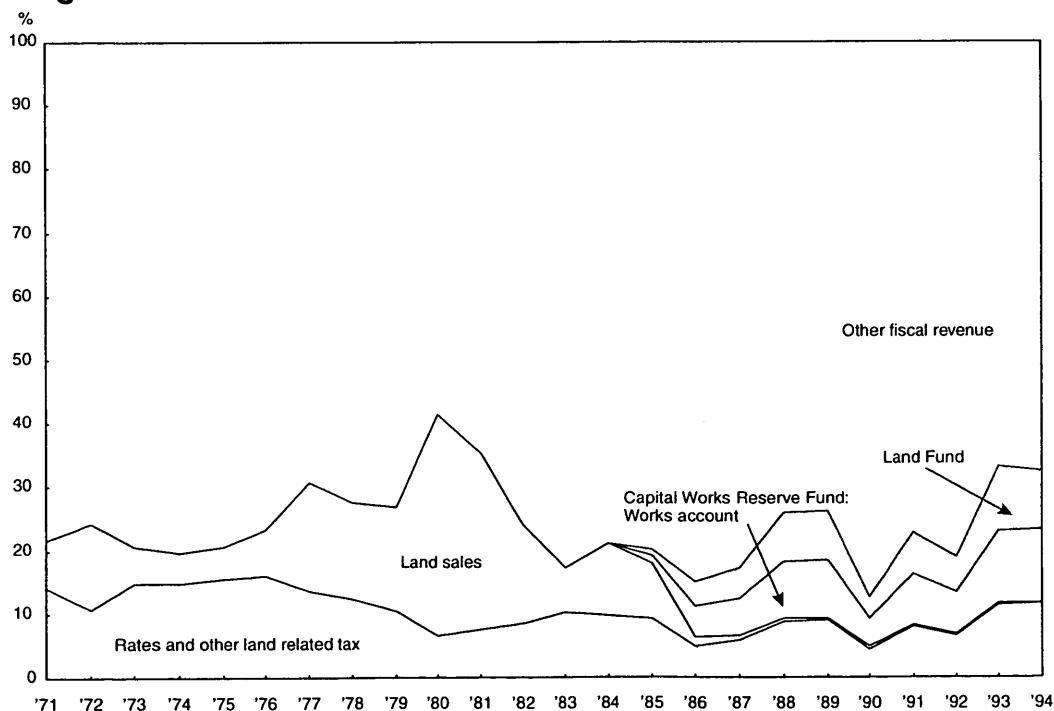
The Chinese government was also well aware of the importance of land-related revenue. The Annex 3 of the Joint Declaration in 1984 provided for the deposit of half of the profit from land rented out after 1997 in the "Land Fund" from 1987, after being credited to the "Suspense Account" in the "Capital Works Reserve Fund," for use by the future Hong Kong Special Administrative Region Government. The remaining half was to be credit in a "Works Account" of the Capital Works Reserve Fund" as the share for the present Hong Kong government. Figure 1 also illustrates a plummeting of proceeds from the sale of land since 1985. This is due to the fact that since 1985 these proceeds have consisted only of land with lease contracts expiring before 1997. Other proceeds are categorized into the Land Fund and the Works Fund in the Capital

Works Reserve Fund. The Joint Declaration also provided other new rules on the sale of land after 1985, limiting the size of land which the government can sell at its discretion to less than 50 hectares a year. At the same time, the declaration required approval by the Sino-British Land Commission, which was established by the declaration, on land sales exceeding the limit of 50 hectares, land use and price, and areas actually leased. The Chinese side has already started to govern Hong Kong on this sphere of land management.

Figure 1 further shows that far from decreasing, the share of land-related fiscal revenue increased especially in the 1990s, despite restriction by the declaration. This reveals an attitude of active gain from land management on the Chinese side. These active land sales brought a massive surplus fund to the Hong Kong government. Though, in a conventional account, the budget was estimated to record a small deficit of 2.5 billion for 1995/96,¹ the Hong Kong government actually enjoyed fiscal surplus when this fund, which was credited to the Land Fund, is taken into account.

Government spending on infrastructure and property also made up a certain amount of total

Figure 1: Share of Land-Related Items in Fiscal Revenue



expenditure. Among total government consolidated expenditures, she spent 25% to 30% on construction and building and 10% to 15% on housing. Looking at shares in investment expenditure in GDP terms, the government has spent an average 35% of the total since the 1980s.²

In total, the government earns around 20% to 30% of revenue from land, and spends almost the same share of total expenditures on building and construction. The government has developed “land” from “land.” In net terms, the government secured a surplus in the fiscal reserve as well. In this regard, the government has been criticized for keeping property prices artificially high in order to expand their revenue. This argument will not be studied here in detail. Instead, the following two sections will outline supply and demand factors related to property, mainly from a macro point of view.

Property Supply: Mixing public and private actors

The second feature of land management in Hong Kong is a strong commitment from the government toward the construction of property. The housing problem has been a particularly consistent major target of government public policy during the post-World War II period. This problem is also an extremely common and complicated issue within local society, because housing is a matter of basic need and, moreover, certain housing still remains at an unsatisfactory level. It is rather difficult to get a whole picture of the housing problem in Hong Kong. This is due to the existence of heterogeneous players; public corporation and private companies.

Half and half

Table 1 shows the change in ratios among types of housing since the 1960s. Here you can see that between 30% to 40% of households in Hong Kong have lived in public rental and temporary housing since the 1970s. Other households lived in private permanent (self-contained type) and temporary housing. The former accounted for around 40%, slightly larger than total public housing. The share of private temporary housing decreased from about 10% to 3% during the same period. On the other hand, households living in Housing Authority

Home Ownership Schemes increased its share from 1% to around 10%. In total, the public sector supplied around 40% of domestic property, and increased slightly faster than the private sector.

As a whole, half of the population in Hong Kong is living in public housing, among which the share of owner-occupier is increasing, and the other half are living in private self-contained housing (ratios between rental and ownership among the latter is not available). This share has not basically changed since the 1970s. The private and public sector maintained equal shares of the housing supply at “half and half.”

Principles of property suppliers

Are there then any differences between the targets of these public and private players in the housing supply market in Hong Kong? First, the private sector's principles are very clear. They buy land from the government, build up the property on the sites and supply housing at prices which maximize profits. A report by the Consumer Council investigates whether oligopoly in the private domestic property market in Hong Kong exists, based on analysis of the industrial organization theory.³ This report points out that developers may be ruining the consumer surplus by exploiting the asymmetry of information. However, the council admits that it could not find sufficient evidence of collusion among developers. It may be correct to argue that private developers are likely to maximize profits through “perfect market competition.” The report proposed seven recommendations for improving the competitiveness of the market structure, including for example, reducing the size of lots in land sales and restricting date controls for selling.

The behavior of public sector players, secondary players in the market, looks more ambiguous, and they seem to follow several principles, sometimes rather contradictory. The government, with sole ownership of land, developed massive public housing and promoted renewals. For example, it supplies land at no charge for housing development by the Housing Authority, an independent public body. It can easily be imagined that without monopolized land ownership by the government, this exceptional treatment of the Housing Authority, or at least maintaining the present size of public housing would be impossible.

Table 1. Domestic Households by Type of Living Quarters

Type of living quarters	Number of households (thousands)											
	1961	1966	1971	1976	1981	1982	1983	1984	1985	%	%	%
Public housing blocks												
Public and aided rental blocks	#	#	263.2	31% 340.7	34% 413.1	33% 464.7	35% 489.3	37% 510.7	37% 519.5	37%	37%	37%
Housing Authority Home Ownership Scheme Estates				7.2	1% 13.1	1% 21.0	2% 28.6	2% 40.3	3%	3%	3%	
Urban improvement scheme blocks			511.9	60%					0.3	0.0%		
Private housing blocks												
Self-contained												
Whole houses/flats	57.4#	9% 372.4#	49% 484.2	49% 588.6	26% 588.6	45% 583.8	44% 600.4	44%	410.0	29%	29%	
Rooms/bedspaces etc.		275.0	36%	258.1	21%				199.2	14%	14%	
Non-self-contained	12.3	2% 60.9	8% 17.5	2% 3.3	0.3% 2.6	0.2% 2.8	0.2% 2.8	0.2%	2.0	0.1%	0.1%	
Villas/bungalows/modern village houses									32.2	2%	2%	
Simple stone structures	480.0	72% 34.7	4% 57.8	5% 55.8	4% 53.0	4% 53.0	4% 53.0	4%	55.5	4%	4%	
Other permanent housing			16.4	2% 31.8	3% 27.1	2% 24.6	2% 28.5	2%	33.1	2%	2%	
Temporary housings												
Housing Authority cottages/temporary huts			6.9	1% 26.5	2% 29.9	2% 33.5	3% 35.4	3%	36.3	3%	3%	
Private temporary housing	116.9	18% 54.7	7% 71.6	8.5% 89.9	7% 88.1	8% 93.5	7% 87.1	6%	85.3	6%	6%	
Total	666.6	100% 763.0	100% 846.7	100% 990.3	100% 1237.6	100% 1311.6	100% 1334.3	100%	1378.7	100%	100%	
# Figures of public rental blocks are included in private housing blocks during these years and cannot be separated.												
Type of living quarters	1986	1987	1988	1989	1990	1991	1992	1993	1994	%	%	%
Public housing blocks												
Public and aided rental blocks	532.7	36% 544.0	36% 552.2	36% 562.8	36% 578.7	37% 597.1	37% 627.3	38% 631.7	38%	38%	37%	
Housing Authority Home Ownership Scheme Estates	57.6	4% 65.2	4% 79.9	5% 88.5	6% 100.8	6% 117.3	7% 127.3	8% 145.9	9%	9%	10%	
Urban improvement scheme blocks	1.1	0.1% 1.3	0.1% 1.7	0.1% 2.4	0.2% 3.5	0.2% 3.9	0.2% 5.4	0.3%				
Private housing blocks												
Self-contained												
Whole houses/flats	441.1	30% 476.4	32% 512.0	33% 534.2	34% 555.0	36% 569.9	36% 589.6	36%				
Rooms/bedspaces etc.	191.6	13% 167.3	11% 157.7	10% 127.8	8% 114.5	7% 115.2	7% 100.7	6%				
Non-self-contained	3.0	0.2% 2.7	0.2% 1.9	0.1% 0.8	0.1% 0.3	0.0% 0.5	0.0% 0.1	0.0%				
Villas/bungalows/modern village houses	46.4	3% 44.0	3% 45.2	3% 47.0	3% 59.1	4% 61.4	4% 57.4	4%				
Simple stone structures	51.8	4% 50.1	3% 51.2	3% 42.9	3% 36.6	2% 35.5	2% 36.8	2%				
Other permanent housing	29.3	2% 30.1	2% 30.0	2% 33.4	2% 26.7	2% 27.9	2% 26.5	2%				
Temporary housings												
Housing Authority cottages/temporary huts	36.1	2% 37.3	2% 36.6	2% 35.6	2% 30.4	2% 26.2	2% 23.0	1%	19.9	1%	1%	
Private temporary housing	82.5	6% 77.7	5% 64.2	4% 73.5	5% 53.3	3% 48.2	3% 45.9	35%	42.2	3%	39.9	
Total	1473.1	100% 1496.1	100% 1532.6	100% 1549.0	100% 1559.0	100% 1603.1	100% 1640.0	100%	1681.3	100%	100%	

Note: Excludes domestic households living on-board vessels

Sources: 1. Census Population and By-Census Population totals for 1961, 1966, 1971, 1976 and 1981.

2. From General Household Surveys (tables in Hong Kong Social and Economic Trends) for 1982-1994.

The major public and semi-governmental bodies which are operating in the property-related businesses are: (1) Housing Authority which is building public rental housing, and Home Ownership Scheme flats, (2) Housing Society, which mainly supplies flats for sale and is building Sandwich Class Housing Scheme, Flat-for-Sale Scheme and Urban Improvement Scheme units, (3) Land Development Corporation, which was established in 1985 for the purpose of urban renewal and also provides flats for sale, (4) Metro Transport Railway Corporation, which is a public body responsible for subway management and also provides residential flats on its sites. The cumulative supply of these bodies almost equalled private housing's one year production,⁴ and (5) Private Sector Participants Scheme. This scheme is a form of flat production through cooperation between the public and private sectors, also building flats for sale by private sector under certain governmental regulations.

Criticism on public housing supply

As with the public body players, there are also various criticisms and opinions of government housing and land policies. Some argue this problem from the viewpoint that housing is a commodity supplied under market rules. They tend to criticize the government on its policy related to the domestic property market, regulation of property prices, interest rates and urban development policy. This is completely true of the domestic housing market in which private players supply. Others argue from the standpoint that housing is a basic need that government should supply as public goods. Accordingly, they often criticize the government's ownership promotion policy.

The government housing policy is often criticized for its “planning bias.” The government, though it began promoting home ownership in the 1970s, still retains the idea of quantitative management within the Housing Department and the Housing Authority. First, priority given to quantitative planning, mainly based on demographic projections, has long been criticized as one reason for poor housing conditions in Hong Kong.⁵

Chau points out that government constructed housing so blindly that quality was extremely low, especially until the 1970s. The per capita adult space in public housing built at that time was 3.3 square

meters. This constitutes inadequate housing conditions, inferior to the 5.25 square meter space considered a basic need by the ILO.⁶ Li and Yu also point out that the government's ill-designed regulations on flexible use of space lead to wasted subsidies, with tenants receiving only four cents value to one dollar spent by the government on public housing in the 1970s.⁷ However, it is pointed out that the provision of low-quality housing at prices lower than “equilibrium” improved somewhat with the establishment of the Home Ownership Scheme in the 1970s, under which the government began selling units.

In the 1990s, a problem caused by inefficient allocation came into dispute again in another form. This conflict appeared at both ends of the income scale. The waiting list for public housing is so long that people must wait seven years on average. At the same time, the number of homeless people, who cannot afford to live in private rental housing, and have not yet received public housing units, has increased. At the top end of the income scale, affluent tenants who have become able to afford second houses on the private market, but are still staying in public housing units have become a problem. This phenomena reveals that housing supplied by the government has not worked efficiently enough in terms of distribution. Moreover, this inefficiency may have led to the formation of a public housing-subsidized class, and a non-subsidized class, especially in the long-term.

In order to cope with these misallocation and price appreciation problems, the government implemented several policies. With regard to the former problem, the Housing Authority has announced that they will introduce a new rule for optimal utilization of public housing, with a criteria of asset limits for tenants and investigation of tenants' assets from April 1997.⁸

The government also launched a policy to increase the supply of housing with the implementation of an action plan following the recommendation of the Task Force on Land Supply and Property Prices in 1994, when property prices overwhelmingly appreciated. This plan consists of two parts: a policy to curb speculation and a policy to increase the supply of housing and land. In 1996, the government also announced the Urban Renewal Strategy in June and a plan of Overall Hong Kong Development Strategy, a long-term strategy until

2011, in July. These plans and policies are aimed to expand the supply to market.

Some have criticized a tendency on the part of government which neglects the market mechanism. Anti-Speculation policy has especially invited criticism. Lawrence Lai criticized the anti-speculation policy as just raising search costs, and posits that prices will be determined at an equilibrium level anyway.⁹ Fu Yuming argued that the appreciation of property prices was a result of rational behavior in a market environment with high yield rental and low real mortgage interest rate, not simply due to speculators' misbehavior.¹⁰ The second policies, promotion of urban renovation and the increase of housing supply were welcomed as moving on the right track. These measures are also unique to the Hong Kong government.

The factor of demand for property and land in Hong Kong will not be discussed. However, average households in Hong Kong are predicted to be able to invest in property from their income. Demand for property and housing is also subject to change by the investment behavior of households and their life-time plans. Next, we will outline asset size with a view toward the structure of demands for asset, including property.

Asset Structure of Hong Kong: Property size as an asset

In an open economy like Hong Kong, it is difficult to trace a whole picture of where people invest their money. However, household and individual portfolios are key factors which affect the demand for property due to the nature of assets, as well as a space consumption goods, or the production factor.

Relative size of assets against flow and relative size among assets

We will lay out here two series of calculations measuring the size of assets. One is the "relative size against flow," size compared with the nominal GDP. The other is "relative size among assets," taking total property value as the numerator.

Table 2 shows outstanding financial assets in Hong Kong, bank assets, equity, debt and total property values since 1985. "Relative size against flow" in this table indicates that banking sector assets are overwhelmingly large in Hong Kong. Total bank assets equalled almost six to seven times

Table 2. Outstanding Financial Assets and Property Values (denominated by Nominal GDP)

	1985	*	1988	1990	1991	1992	1993	*	1994	1995
Total Bank Asset	573%	2.46	813%	898%	841%	736%	676%	2.14	720%	706%
(Total Loan)	82%	0.35	89%	104%	108%	104%	107%	0.34	110%	111%
(Loan to property, building)	28%	0.12	32%	44%	49%	47%	50%	0.16	54%	51%
Total Market Capitalization	154%	0.66	128%	112%	142%	171%	332%	1.05	205%	211%
(Equity of Developers)	n.a.	n.a.	n.a.	29%	38%	43%	95%	0.30	52%	56%
Debt	n.a.	n.a.	n.a.	6%	6%	6%	9%	0.03	15%	18%
Total Property Value	232%	1					316%	1		

Sources: Hong Kong Monetary Authority, *Annual Report 1995, 1994*, and other materials distributed at interviews Commissioner of Rating and Evaluation Department, *Annual Summary*, various issues
Table 3 for Total Property Value

Note: *: Relative size of assets are denominated by Total Property Value.

Table 3. Size of property values (denominated with nominal GDP)

	01/04/85	01/04/89	after 04/06/89	01/04/93	01/10/93
Estimated Total Value of Property	232.4%	291.4%	237.0%	315.8%	367.5%

Sources: Estimates are derived from A. Walker, K.W. Chau and L.W.C. Lai, *Hong Kong: Property Construction and Economy 2nd ed.*, London: Royal Institution of Chartered Surveyors, 1994/*Hong Kong in China: Real Estate in Economy*, Brooke Hillier Parker, 1995

the GDP after 1988. Outstanding equity, that is total market capitalization, fluctuated between two and four times of the GDP, almost one-third to half of banking sector assets. The debt market in Hong Kong matured in the late 1980s. Outstanding assets are therefore rather small, but have been steadily increasing recently. Among financial assets, people have preferred to invest in the banking sector, with the stock market ranking second.

Table 3 shows property values for 1985, 1989 and 1993.¹¹ These estimates are based on the assumed discount rate, and its reliability is therefore limited. However, these figures give some hint in understanding the structure of assets in Hong Kong illustrated in Table 2. You can see here that total property values in Hong Kong are smaller than total bank assets, approximately less than half, but were slightly larger than total market capitalization of the stock market in both 1985 and 1993. In 1993, equity values swelled to about 150% of 1985 figures, though other assets remained at the same level. 1993 saw drastic asset appreciation, with some arguing that this was induced by capital flow from mainland China. Data for other years and more precise surveys are required to argue this in more detail. Looking at these figures, however, it is difficult to say that property was not unusually high or volatile from "speculation."

Comparison with US, UK and Japan

Table 4 summarizes asset size in the U.S., U.K. and Japan in 1985, and Table 5 offers a summary for 1988 to 1994 in Japan.¹² This asset data is derived from asset balance sheets in the National Account and denominated by each nominal national ac-

Table 4.
Outstanding Assets of US, UK and Japan
(denominated by nominal national income)

	US		UK		Japan	
	1985	1985	1985	1985	1985	1985
All financial assets	560%	2.78	857%	3.19	844%	1.62
Equity	76%	0.38	100%	0.37	96%	0.18
Pension funds	56%	0.28	59%	0.22	37%	0.07
All physical assets	402%	1.99	580%	2.16	723%	1.39
Land	92%	0.45	153%	0.57	404%	0.78
Domestic property	110%	0.55	116%	0.43	116%	0.22
Land + Property	202%	1	269%	1	520%	1

Sources: Estimates from Ishikawa (1990); "Wealth of Households and Firms; On concentration of wealth in Japan," in K. Nishimura and Miwa, Y. ed., *Stock and Land Prices in Japan* (in Japanese), University of Tokyo Press, 1990.

count. Therefore, figures in these tables are not exact counterparts of Hong Kong's data in Tables 2 and 3. It can be easily imagined that Hong Kong data includes assets of non-residents of Hong Kong. However, the U.K. also maintains a similar open financial market. This comparison may therefore offer some implications.

First, the U.S. recorded total financial assets of 5.6 times the GDP, the U.K. 8.6 times, and Japan 8.5 times of output. The U.K. and Japan recorded almost the same Total Bank Assets as Hong Kong for 1985. Relative size of financial assets to physical assets are: U.S. 1.4, U.K. 1.5 and Japan 1.2. In Hong Kong, equity plus debt was about 1.1 times of property values in 1993. According to figures here, the size of financial assets in Hong Kong is quite large. Among financial assets, equity in Hong Kong was the largest among the four economies in 1985.

Table 5. Outstanding Assets: Japan

	1985		1988		1989		1990		1991		1992		1993		1994	
1. Tangible assets	563.2%	1.15	738.9%	1.10	788.0%	1.10	807.6%	1.10	732.1%	1.11	674.7%	1.12	662.9%	1.12	655.7%	1.12
Property	117%	0.36	178%	0.27	183%	0.26	187%	0.25	188%	0.28	193%	0.32	200%	0.34	206%	0.35
(Residential buildings)	49.7%	0.10	48.8%	0.07	50.3%	0.07	50.7%	0.07	49.9%	0.08	49.9%	0.08	51.2%	0.09	52.2%	0.09
Land	313.2%	0.64	492.1%	0.73	534.2%	0.74	550.0%	0.75	473.5%	0.72	412.1%	0.68	392.2%	0.66	380.6%	0.65
Land + Property	490.6%	1	670.1%	1	717.6%	1	736.7%	1	661.9%	1	604.7%	1	592.2%	1	586.8%	1
2. Financial assets	665.2%	1.36	864.0%	1.29	926.5%	1.29	851.9%	1.16	828.5%	1.25	788.8%	1.30	810.2%	1.37	838.2%	1.43
Deposit	154.9%	0.32	180.2%	0.27	186.0%	0.26	185.5%	0.25	183.1%	0.28	184.6%	0.31	190.5%	0.32	195.7%	0.33
Debt	86.1%	0.18	86.1%	0.13	86.1%	0.12	86.1%	0.12	86.1%	0.13	86.1%	0.14	86.1%	0.15	86.1%	0.15
Equity	75.5%	0.15	178.9%	0.27	222.5%	0.31	138.2%	0.19	127.8%	0.19	85.2%	0.14	85.7%	0.14	95.7%	0.16
Total assets	1228.4%	2.50	1602.8%	2.39	1714.5%	2.39	1659.5%	2.25	1560.6%	2.36	1463.6%	2.42	1473.1%	2.49	1493.9%	2.55

Source: Economic Planning Agency, *Annual Report of National Accounts, 1996*

Relative size among assets seems to exist within a different asset structure in Hong Kong than in these economies. In 1985, size of property value in Japan was prominently large, which pushed the size of other assets down. Size of land plus property in Japan during this period amounted to three to six times of the GNP. During this period, Japan experienced extraordinary asset appreciation. It is also interesting that the relative size of U.K. and the U.S. are very similar, with the exception of larger total financial size in the U.K. than in the U.S. When compared to the U.K. and the U.S., Hong Kong's equity size has increased. As far as this data shows, the size of property values in Hong Kong did not reach an extraordinary level, at least not unusual levels as in Japan in the late 1980s. Here again, it is difficult to say that property value and price (numerated by GDP) in Hong Kong, or demand for property, was extremely high.

Mortgage Security Corporations and Debt Market Growth

Nonetheless, as mentioned before, land and property are still important objects of investment by people in Hong Kong. Investment in Hong Kong is somewhat concentrated in the property sector. Loans to property-related projects reached a high share of total loans by financial institutions, affecting the structure of the entire financial market.

As shown in Table 2, loans for property development and investment, though restricted to 40% of total loans by restricted banks, reached almost half of the GDP in 1993. The equity of developers made up around one-fourth of total capitalization, the largest in the industrial classification on the stock exchange. In addition, this does not reflect company development activities classified into other industrial sectors. Similarly, investment in both indirect and direct finance relies not negligibly on property-related projects. Thus, fluctuating property values have affected the economy seriously. A fall in real estate prices reduces bank assets and could therefore induce a liquidity crisis in the economy as a whole, which Hong Kong has repeatedly experienced in the past. A drop in property prices in the mid-1960s threatened the liquidity of a large number of banks, with rumors of bankruptcy causing depositors to run to banks. At this time, the Hang Seng Bank, the largest local bank then, expe-

rienced a run on deposits and ended in merging with the Hong Kong Shanghai Bank, despite the soundness of its actual state of operation and finances.

This excessive reliance on real estate financing and its tendency to trigger liquidity crises was a vulnerability in the Hong Kong financial market. Several measures have been implemented in order to solve this problem, and this movement will end with recent changes in the financial market in Hong Kong and the growth of the debt market in Hong Kong.

Securing massive mortgage loans is a measure to improve liquidity in the financial market. In 1994, two American banks issued mortgage securities in Hong Kong. The government also submitted a plan to establish a mortgage corporation which will be publicly financed, for purchasing mortgage securities. According to a detailed proposal by the Hong Kong Monetary Authority,¹³ initial capital of HK\$1 billion would be drawn from the Exchange Fund and the capital/asset ratio would be set at 5%. The corporation would therefore be able to purchase up to HK\$20 billion in mortgage loans, approximately 6% of current real estate-secured loans, and 2% of the 1995 nominal GDP. Through this corporation, banks, especially medium and small banks, would be able to liquidate their real estate-secured assets.

Opinions are split as to whether the establishment of such a securities corporation will be advantageous to home buyers. As discussed before, the size of property assets is not extremely large at this stage, especially compared with financial assets. It is difficult to say that a bubble in property prices exists even in 1993, when property price appreciation was extreme after 1990. It is also difficult therefore to say that this securization plan will escalate asset appreciation. On the other hand, under a privatization policy of public housing flats, outstanding mortgage loans are expected to increase, which could lead to a liquidation crisis in the future. Taking both needs and safety into consideration, this mortgage security program has a rational basis.

Furthermore, this also contributes to the promotion of debt market growth. In 1989, the government started to encourage bond market growth by issuing Exchange Fund Bills and Notes intended to strengthen Hong Kong's financial market. The establishment of Mandatory Provident Funds at the end

of 1996 means the appearance of major institutional players in the long-term fund market, which will collect 5 to 10% of wages as insurance premiums and is estimated to reach a total of HK\$40 billion a year at the end of 1997. Large investors in long-term funds, which Hong Kong's financial market lacked, are also expected to enhance the functions of long-term markets and the Hong Kong financial market as a whole.

Concluding Remarks

“Borrowed land” served as a source and a form of wealth in Hong Kong. The rising or falling of the value of this land in the future will be a direct indicator of the trends in the Hong Kong economy after the hand-over.

The size of government account funds will possibly become a particularly important factor in the future of the Hong Kong economy. Future fiscal conditions of the SAR government are predicted to remain very sound, though very pessimistic opinions do exist. The Financial Secretary also expressed an optimistic fiscal position, including the establishment of the Land Fund which will register HK\$ 150 billion and \$365 billion surpluses at the end of March 1997 and 2000, respectively.¹⁴ The Hong Kong government has several funds in its capital account which could be utilized as management sources for the SAR government. The “Exchange Fund,” which was formed to maintain the value of the Hong Kong dollar, recorded total assets of HK\$ 460.7 billion (256% of the GDP) and a cumulative balance surplus HK\$160.1 billion¹⁵ (89% of the 1995 GDP) at the end of 1995. Practically, this fund has been managed as a internal “bank” of government, and this surplus includes the government “savings” fund of HK\$125.9 billion, a credit from the current account surplus. As described earlier, two land-related funds, the Land Fund (cumulative balance surplus as of the end of 1995 of HK\$85.0 billion,¹⁶ equal to 47% of GDP) and the Capital Works Reserve Fund have recorded large surpluses. Note that, as of July 1, 1997, the Land Fund will be incorporated into the Capital Works Reserve Fund, with the SAR government forecast to record large saving surpluses.

Structural change in local social politics are pressuring the government to change its conservative policy. Pressure on the government to form an

allowance for senior citizens has emerged as discussed in another chapter. Demand for government commitment to smooth industrial structural change, in addition to construction of a “conventional” infrastructure has also emerged.

To date, an opinion exists that the conservative fiscal management and government infrastructure construction has not caused serious economic problems in terms of the shrinking or crowding out of effective demand. However, this may not be completely true. The government surplus has partly been achieved with stable revenue from land and property-related items as discussed here, and government could maintain high reserve funds without raising tax rates. It may, however, be time to reconsider fiscal management policy and make a stronger commitment to structural societal changes, some of which are dependent on the hand-over of Hong Kong and others independent from it.

Notes:

- 1 *The 1996-97 Budget Speech by Financial Secretary*, The 1995/96 Outturn, Sec.23.
- 2 Walker, A. Chau K. W, and L.W.C. Lai, *Hong Kong: Real Estate in the Economy*, Brooke Hillier Parker, 1994. Table 3.15 and Table 3.16.
- 3 Consumer Council, *How Competitive is the Private Residential Property Market?*, July 1996.
- 4 *Ibid.*, Annex 3, note 1.
- 5 L.C. Chau, “Public Housing,” in H.C.Y. Ho and L.C. Chau ed., *The Economic System of Hong Kong*, Asian Research Service, 1988/L.C. Chau, *The Growth Impact of Hong Kong's Housing Sector*, a paper presented at the Conference of the Southern Economics Association, 1992/ Li, S. M. and F.L. Yu, *A Study of Hong Kong's Urban Problems (in Chinese)*, Commercial Press, Hong Kong 1986, / Lawrence W.C. Lai, “The Property Price Crisis,” in MacMillen, D.H. and S.W. Man ed., *The Other Hong Kong Report 1994*, The Chinese University Press.
- 6 L.C. Chau, “Public Housing,” in H.C.Y. Ho and L.C. Chau ed., *The Economic System of Hong Kong*, Asian Research Service, 1988.
- 7 Li, S. M. and F.L. Yu, *A Study of Hong Kong's Urban Problems (in Chinese)*, Commercial Press, Hong Kong 1986, pp
- 8 Ad Hoc Committee on Private Domestic Property Ownership by Public Rental Housing Tenants, Housing Authority, *Safeguarding Rational Allocation of Public Housing Resources—Report on Final Recommendation*, June 1996.
- 9 Lawrence W.C. Lai, “The Property Price Crisis,” in MacMillen, D.H. and S.W. Man ed., *The Other Hong*

- Kong Report 1994*, The Chinese University Press, pp206-207.
- 10 Yuming Fu, "Housing Market and Housing Prices," in Stephen Y.L. Cheung and Stephen M.H. Sze ed., *The Other Hong Kong Report 1995*, The Chinese University Press.
- 11 Estimates by Walker, Chau and Lai¹¹ are used here. This property value is derived from the Rateable Value, which the Rating and Evaluation Department assessed for the purpose of rate charges, capitalized by an assumed capitalization rate./ Walker, A. Chau K. W, and L.W.C. Lai, *Hong Kong: Real Estate in the Economy*, Brooke Hillier Parker, 1994. Table 3.1 and Annex 3./ Walker, A., K.W. Chau and L.W.C. Lai, *Hong Kong : Property Construction and Economy* 2nd ed., Royal Institution of Chartered Surveyors, 1990. Table 3.1
- 12 Estimation method differs in 1985 from the other years. In 1985, the size of pension funds is reestimated for the other items.
- 13 Hong Kong Monetary Authority, *Mortgage Corporation Proposal*, April 1996.
- 14 *The 1996-97 Budget Speech by Financial Secretary*, Medium Range Forecast, Sec. 87. A Chinese representative revealed at the China Britain Land Commission that Land Fund stocks will reach 100 million on 1st July, 1997. *Hong Kong Economic Times*, 18 September 1996.
- 15 Hong Kong Monetary Authority, *Monthly Statistical Bulletin*, 1996 April.
- 16 The use and form of Land Fund under SAR government is still under dispute.